

18 FEB 1975

Honorable John M. Thomas  
Assistant Secretary for Administration  
Department of State  
Washington, D. C. 20520

Dear John:

This memorandum represents the views of the Central Intelligence Agency with respect to the taxation proposal by the representative from the Department of the Treasury. It contains the reasons why I believe that the Committee should oppose the proposal as strongly as possible. The memorandum is for your information, and it is requested that it not be disseminated. I apologize for its length, but the issue is a vital one and deserves maximum attention.

The basic flaws in the Treasury proposal are the assumptions that (a) all United States citizens overseas are substantially identical in terms of the economic structures within which they live and the interests they represent, and (b) that the U. S. Government either could or should bring about equality through tax legislation. Actually, these overseas Americans fall into three distinct categories which have little in common other than their citizenship. These categories are (a) the U. S. military, (b) the civilian service, and (c) private business interests. These groups exist overseas for entirely different objectives, they live under different circumstances, they react to different stimuli, and it would be a serious mistake to enact major legislation on the premise that all are alike.

In comparing the business community with the civilian services of the government, the differences are immediately apparent. The civilian services are established overseas to represent the foreign affairs interests of the country, which obviously includes a recognition of the costs involved in the overseas presence and a willingness to pay those costs. The services performed produce no revenue, and the costs must be carefully controlled by appropriations. The private business presence, however, is intended only to produce a profit for those who sponsor it, the presence is maintained as long as the profits are high enough to justify it, the benefits of the employees can be escalated to almost any level as long as they are below the revenues which are produced, and when

profits fall below an acceptable level the presence is simply packed up and returned home. Since motivation and objectives are different, compensation and incentive are also different. We know of no overseas corporation which has ever stipulated that its overseas representatives could be paid no more than the American Ambassador to the same country. Within the past few days the media has publicized a contract between an American airline and a pilots' union which provided contracts worth as much as \$80,000 per annum to overseas pilots. This is a clear indication that the private business interests are willing to establish compensation levels well above those of the U. S. Government. Consequently, sections 911 and 912 of the IRS Code can certainly be considered separately in terms of U. S. taxation policy. If section 912 is to be modified it should be on the basis of the facts and not attributed to "equity" with the business community. We should also note that corporations, in sending U. S. citizens abroad, normally concentrate on managerial and executive personnel. For middle level staffing, and even some managerial positions, they use local nationals who do not have to be paid allowances and salaries based on the U. S. pay scales. The government civilian services, and especially the intelligence services, cannot use foreign nationals to represent their interests. The trend toward the use of foreign nationals by corporations is being accelerated by the current economic problems, and the disparity between the overseas corporate benefits and those of government employees can be expected to widen.

The benefits and tax considerations concerning military personnel are also entirely unlike those of either the civilian services or the private business community. Except for the relatively small number of military personnel affiliated with the embassies, military forces overseas have salary structures established by Congress on the basis of their unique requirements, they operate in an entirely different environment, and are subject to entirely different controls by the Congress. In many cases their presence is controlled by separate treaties which are, of course, subject to Senate approval. We defer to the DOD in the assessment of its own situation and the proposed changes, but we are convinced that the circumstances of military service are so dissimilar to those of foreign civilian life that major government policies should not be established on the assumption that they are alike. U. S. Government policies with respect to overseas representation must make a distinction between civilians living in a foreign community and military units stationed in U. S. military bases abroad.

The referent proposal states that the Committee decided to repeal section 912 because, among other reasons, the original justification for section 912 was no longer relevant. The original justification is described as a wartime necessity because rapidly rising living costs were imposing a heavy financial burden on overseas personnel, the personnel were vital to the war effort, and the State Department could not increase its appropriation. The study concludes with the statement (on page 6) that the wartime emergency has ended and appropriations should be increased to reflect additional allowance requirements. We do not

agree. The memorandum points out that the action in 1943 was a reaction to the costs, not to the hazards of war. The costs today have risen to a degree which could never have been imagined in 1943. Further, anyone who feels that U. S. Government agencies today are faced with fewer budget pressures than they were in 1943 is clearly misinformed. I cannot imagine that the Congress today would increase the appropriations of any government agency if it understood that, notwithstanding an increase in taxes of the civilian employees, the result would be a net loss to the government. While the war ended 30 years ago, the fact is that inflation is now higher and the dollar is less valuable, so the economic factors which justified concessions by Congress in 1943 are not only present but intensified today.

The Treasury study seems to focus on the quarters allowance, and assumes that this represents a net profit for the employee overseas as compared to his colleague in the United States. This is not necessarily the case. An employee who is provided quarters overseas or is paid a housing allowance may receive short-term benefits to the extent that he is not paying for an apartment in Washington. However, most employees who are stationed in Washington are not renting apartments. Instead, they are purchasing homes which represent substantial assets over a long period of time, which are probably the largest part of their net worth, and which provide a number of tax benefits in the form of interest on mortgages, etc. The employee overseas may not pay for his quarters, but neither is there a residue of net worth which he can retain. Thus, in terms of comparative costs, it is difficult to conclude that the employee overseas necessarily has a significant cost advantage. Certainly there is no discrepancy which is so great that income taxes of the overseas employee must be increased in order to enforce comparability with service in Washington. The hidden costs associated with service overseas and the constantly decreasing attractiveness of life abroad have already caused many employees to think twice before accepting foreign assignments. At one time it was possible for a family overseas to live a reasonably gracious life and profit somewhat from the experience. Now, however, most wives feel that if they must do their own housework and struggle to make ends meet, they might as well do it in the United States where they understand the language, have the supermarkets and labor saving devices, and have their friends and relatives as associates. Overseas service today does not have all the attractive features it once had.

The study discusses several reasons for retaining section 912. There are, however, other more cogent reasons which are not discussed. The first of these is that, over the past four decades, the allowances have been an integral part of the standardized benefits of government employment. These benefits have been carefully studied, administered, adjusted, and approved by the Congress over the years, with careful consideration being given to taxable salaries paid to employees, the unique character of overseas service, the requirements of the government, and equity to employees. For the Treasury Department to suggest

now that the tax free status of allowances was actually a legislative mistake, enacted in a wartime situation 32 years ago, overlooks the effort that has gone into the development of the total package over the years. Any changes in that basic package should be carefully studied and not viewed as a minor tax reform.

The next reason for the retention of the present system is that the proposed change would not produce additional revenue, but would in fact result in a net loss to the government. The study acknowledges that the allowances would have to be increased to offset the taxes to be levied. In addition, there would be a substantial increase in the workload of simply recording the payments in government records, to say nothing of the increased burden on the employee/taxpayer in submitting his return, and in the IRS in processing it. Disbursements which are now charged to expense at the overseas posts would thereafter have to be transferred to headquarters for a centralized control and ultimate inclusion in the tax withholding reports provided to the taxpayer and to the IRS. Thus both the employee and the government would lose. The employee would lose because his basic salary would be taxed at a higher rate and the increase in taxes would be more than the increase in his allowances. The government would lose because the slight increase in revenue would be much less than the cost of larger appropriations for allowances, in addition to the cost of nonproductive record keeping at the field installation, at headquarters, in IRS, and on the part of the taxpayer. In such an arrangement it is simply not possible for anyone--either the government or the taxpayer--to be better off than under the present system. We would have a situation where the tax collection system would have become an end in itself without regard to the practical considerations.

In summary, we feel that the changes proposed by the Treasury would be destructive of morale, force government employees to accept a substantial increase in income taxes at a time when the President is proposing a tax decrease for all other U. S. taxpayers, would not increase revenues for the government, and would in fact result in substantially increased collection costs and reduced efficiency. We would, of course, support policy changes which would standardize the benefits of all government civilian employees overseas without penalizing the vast majority of them.

Sincerely,

John F. Blake

John F. Blake  
Deputy Director  
for  
Administration

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